

SENATE FISCAL AGENCY MEMORANDUM

DATE: March 8, 2006

TO: Members of the Senate

FROM: Kathryn Summers-Coty, Fiscal Analyst

RE: Explanation of the K-16 Coalition for Michigan's Future Funding Initiative

On February 21, 2006, a broad coalition of education interest groups across the State filed with the Secretary of State signatures to trigger the process of an initiative law to provide guaranteed future funding increases in the State budget for K-12 school districts, community colleges, and universities. This memorandum provides an overview of the initiative law process, a discussion of the content found in the initiative (commonly referred to as the "K-16 funding initiative"), and an analysis of the impact of the K-16 funding initiative on the Governor's fiscal year (FY) 2006-07 State budget recommendation.

INITIATIVE LAW PROCESS

The State Constitution of 1963 (Article II, Section 9) provides a process for the citizens of the State to initiate a change in State law. The constitutional process requires petitions signed by not less than eight percent of the total vote cast for all candidates for Governor in the last preceding general election at which a Governor was elected. Based on the 2002 general election, this places the minimum signature requirement for an initiative law at 254,206.

The Secretary of State is now reviewing the number of valid signatures filed by the K-16 funding coalition on February 21, 2006. If the Secretary of State determines that the minimum number of required signatures has been filed, and the Board of State Canvassers certifies the petition, the proposed change in State law will be forwarded to the Legislature.

Once the Legislature receives the proposed initiative law, the Legislature has 40 session days (includes all calendar days Sunday through Saturday until sine die) to act on the proposed law. The Legislature has three options that it can take to deal with the proposed initiated law. First, the Legislature with a majority vote of both houses can enact the law without amendment. If this action occurs, the initiative becomes law. The second option is that the Legislature takes no action on the proposed initiative within the 40-day period. In this case, the initiative will be submitted to the voters at the November 2006 general election. If the voters approve the initiative at the general election, the law takes effect. The third option available to the Legislature is to reject the proposed initiative law and propose an alternative measure within the 40-day time period. In this case, both the legislative proposal and the citizen initiative will appear on the November 2006 general election ballot. If both proposals receive an affirmative vote, the proposal receiving the largest majority vote will take effect. Initiated laws are not subject to the veto power of the Governor.

CONTENT OF K-16 FUNDING INITIATIVE

To summarize, the initiative requires the following funding levels beginning in FY 2006-07:

- 1) Inflationary bottom-line spending increases in K-12, community colleges, and higher education, using FY 2004-05 funding levels on which to apply inflation.
- 2) For K-12: declining enrollment three-year pupil blend for all districts, inflationary increase in the basic foundation allowance, closing the foundation allowance gap by \$300 over six years, and inflationary increases in at-risk, intermediate school district (ISD) operations, and special education.
- 3) Capping local contributions to the Michigan Public School Employees Retirement System (MPERS) at the lesser of 80% of the actual retirement rate or 14.87% applied to payroll, requiring the State to pay the difference between the local contribution and the actual retirement rate.

The first section requires an inflationary increase for FY 2006-07 in gross State spending for K-12 from the 2004-05 fiscal year, and an inflationary increase in gross appropriations for community colleges and higher education as found respectively in Public Acts 358 and 352 of 2004. The consensus estimate of inflation as measured by the U.S. Consumer Price Index is 6.2% over that two-year period, and was reached at the January 2006 Consensus Revenue Estimating Conference. The necessary baseline increase for all three components (K-12, community colleges, and higher education) is estimated at \$165.7 million above the Governor's recommended gross appropriation levels for those budgets.

The second portion of the petition requires specific "guarantees" in funding. These guarantees include an inflationary increase in the basic foundation allowance, Proposal A obligation payment, discretionary payment, At-Risk grant, special education funding, and ISD operational funding. The Governor's FY 2006-07 School Aid budget sets the basic foundation allowance at \$7,075; the initiative would require an additional \$41 per pupil to meet the inflationary increase requirement, bringing the basic foundation allowance to \$7,116. Also, the initiative includes a "declining enrollment" provision for all school districts. In this guarantee, an average of the prior three years' pupil membership blends, rather than the current-year membership blend alone, would be the basis for State aid payments, provided the three-year blend yielded a higher pupil number. Finally, on the operational funding side, the initiative contains a provision to reduce the State funding gap between the basic foundation allowance and the maximum foundation allowance (currently at \$1,300) to \$1,000 over a period of six years. This analysis assumes the \$300 gap closure would occur in equal \$50 increments over each of the next six years.

- Note: The increase in gross baseline funding for K-12, combined with the dollars available in "discretionary" or "nonrequired" categoricals proposed in the K-12 budget provide sufficient funding to pay for the specific funding "guarantees" listed above **provided that** some of the existing School Aid discretionary categoricals are reduced from their FY 2005-06 level and new items in the Governor's budget are not funded. In other words, existing and new program funds (e.g., Adult Ed, School Readiness, or K-3 Math and Science Literacy Grants) are used to offset the costs found in the specific funding guarantees required in the initiative. However, if the K-16 costs were simply

- added *on top of* the Governor's School Aid budget as proposed, then the costs of funding all of the Governor's initiatives *plus* the K-16 requirements would be \$175.0 million more than the \$165.7 million listed above, or \$340.7 million.

Turning to the retirement funding, the local portion of the contributions made by districts, ISDs, community colleges, and participating universities into the Michigan Public School Employees Retirement System would be capped at the lesser of 80% of the actual retirement rate or 14.87% (the FY 2004-05 rate) applied to payroll; the State would pay the difference into the MPSERS. The FY 2006-07 rate as estimated in the Governor's School Aid budget is 17.74%, meaning the local contribution would be capped at 14.19% of payroll and the State would have to pay 3.55% of payroll, estimated at \$380.2 million for all eligible entities in FY 2006-07. (The Office of Retirement Services has not yet published an FY 2006-07 rate for the participating universities. In FY 2005-06, the rate for the participating universities was 0.16 percentage points more than for K-12 and community colleges, and so for this analysis, it was assumed that the FY 2006-07 university rate will be 17.90%. Thus, the State contribution into MPSERS for participating universities is estimated at 3.58% of payroll.)

FISCAL IMPACT OF K-16 FUNDING INITIATIVE

Table 1 shows for K-12, community colleges, and higher education the estimated required operational and MPSERS costs to the State in FY 2006-07, compared with the Governor's recommended appropriation levels in the three budgets for FY 2006-07. As mentioned above, the cost reflected in Operations for K-12 uses much of the Governor's recommended FY 2006-07 appropriations in **nonrequired** categoricals to offset the **mandated** costs of the K-16 proposal.

Table 1

ESTIMATED OPERATIONAL* AND MPSERS COSTS IN FY 2006-07 COMPARED WITH GOVERNOR'S PROPOSED FY 2006-07 GROSS APPROPRIATIONS (dollars in millions)				
	K-12	Community Colleges	Higher Education	Total
Operations*	\$96.3	\$16.3	\$53.1	\$165.7
MPSERS	354.9	20.2	5.1	\$380.2
Total	\$451.2	\$36.5	\$58.2	\$545.9

*Operations estimate for K-12 assumes eliminating new items and reducing some existing discretionary (i.e., nonobligational or discretionary) categoricals in the FY 2006-07 Governor's K-12 budget below the levels appropriated in FY 2005-06. Also, "Operational" or "Operations" means standard operations funding plus any other appropriations in the three budgets.

Table 1 indicates a total cost to meet the requirements of the initiative petition, combining K-12, community colleges, and higher education, of \$545.9 million above the FY 2006-07 Governor's recommended gross appropriations (excluding Federal dollars in the K-12 budget). Of that total, 69.6% is represented by the required State contribution of the MPSERS retirement rate, and 30.4% devoted to operational funding costs.

For years beyond FY 2006-07, it is likely that the MPSERS component of the K-16 funding initiative would comprise the bulk of the costs to the State. Once the base "operational" funding floors for K-12, higher education, and community colleges were established and funded in FY 2006-07, State revenue in FY 2007-08 and beyond, at least in the School Aid Fund, likely would increase at least by the rate of inflation and could pay for the required inflationary operational increases. Thus, the additional cost of the initiative in FY 2007-08 probably would be less than the \$545.9 million estimated for FY 2006-07, but would depend upon the amount of the State contributions required to be paid into the MPSERS. In FY 2007-08 and beyond, retirement costs would continue to be a financial burden on the State as the MPSERS rate and participating entities' payrolls rise.

Attached is a detailed spreadsheet with each aspect of the initiative's financial requirements estimated for FY 2006-07. If you have any questions, please do not hesitate to call.

c: Gary S. Olson, Director
Ellen Jeffries, Deputy Director
Mike Hansen, Chief Analyst

Estimated K-16 Initiative Petition Costs in FY 2006-07
Compared with Governor's Recommended Appropriation Levels

<u>OPERATIONS*</u>	<u>K-12</u>	<u>Community Colleges</u>	<u>Higher Education</u>												
FY 2004-05 Base	\$11,113,522,200	\$285,747,000	\$1,690,150,500												
	+	+	+												
FY 2006-07 Inflationary Increase: 6.2% Applied to FY 2004-05 Base	<u>689,038,376</u>	<u>17,716,314</u>	<u>104,789,331</u>												
	↓	↓	↓												
Total FY 2006-07 Estimated Budgets w/ All Requirements (see below for detail on Specific Requirements)	11,802,560,576	303,463,314	1,794,939,831												
	minus	minus	minus												
FY 2006-07 Governor's Recommendation	<u>11,706,277,800</u>	<u>287,129,400</u>	<u>1,741,840,700</u>												
	↓	↓	↓												
Additional Spending Required Above FY 2006-07 Governor's Recommendation	\$96,282,776	\$16,333,914	\$53,099,131												
<div><div>Specific K-12 Requirements in FY 2006-07 above Governor's Rec. Costs associated with meeting all specific requirements: These costs would replace the \$96.3 million above ONLY IF no other categorical School Aid funding were used to offset K-16 costs.</div><table><tr><td>Declining Enrollment</td><td>\$169,000,000</td></tr><tr><td>Foundation Increase</td><td>52,900,000</td></tr><tr><td>Closing Gap (assumed \$50 per year for six years)</td><td>33,000,000</td></tr><tr><td>At-Risk</td><td>14,330,400</td></tr><tr><td>ISD Operations</td><td><u>2,064,100</u></td></tr><tr><td>Total Specific Costs</td><td>\$271,294,500</td></tr></table></div>				Declining Enrollment	\$169,000,000	Foundation Increase	52,900,000	Closing Gap (assumed \$50 per year for six years)	33,000,000	At-Risk	14,330,400	ISD Operations	<u>2,064,100</u>	Total Specific Costs	\$271,294,500
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<u>MPSERS</u>	<u>K-12</u>	<u>Community Colleges</u>	<u>Higher Education</u>
Local Contributions Capped at the Lesser of 80% of the retirement rate, or 14.87%.			
Estimated FY 2006-07 Payrolls	9,998,078,870	567,941,530	141,193,404
Increased FY 2004-05 payroll by 3% yearly		see note	see note
FY 2006-07 Rate is 17.74%.			
District rate 14.19%; State rate 3.55%			
State Cost:	\$354,931,800	\$20,161,924	\$5,054,724
(University estimated rate: 14.32%; State 3.58%)			
Total Petition Language Estimated Cost - Operations plus MPSERS			
FY 2006-07 ABOVE FY 2006-07 GOV REC	\$451,214,576	\$36,495,838	\$58,153,855
Total Operations and MPSERS for K-12, Community Colleges, and Higher Education:		\$545,864,269	

Note: The SFA received updated FY 2004-05 payroll for K-12, but for community colleges and higher education, the SFA is using FY 2003-04, the most recent data available.

* Throughout the table, "Operations" means standard operations funding plus any other appropriations in the budgets that may not be strictly "operational".